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# **Globalisation and Social Change: Drowning in The Icy Waters of Commercial Calculation**

**Manfred Bienefeld**

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# **Globalisation and Social Change: Drowning in The Icy Waters of Commercial Calculation<sup>1</sup>**

Manfred Bienefeld<sup>2</sup>

## **INTRODUCTION AND SUMMARY**

This paper will make three arguments. First it will suggest that the present process of globalisation involves a significant and ultimately destructive shift in the political and institutional context within which competitive market forces, and the logic of capital, find material expression. Second it will argue that current trends are not sustainable and that they are in the process of generating explosive contradictions that will eventually undermine efficiency and the conditions for the continued accumulation of capital. And finally, it will contend that the only political response that can hope to harness and redirect these forces in a socially responsible and desirable manner, is one that is rooted in societies with a sufficient sense of their common interest and identity to act coherently through a political process that has broad legitimacy and that is primarily concerned with protecting and promoting public welfare. One can think of these responses as versions of Polanyi's "double movement," or as socially rooted forms of class struggle.

This discussion leads to two ultimately unanswerable questions, namely: Are such political responses feasible at all? And, if so, are they likely to materialise in our life time? Such matters of political struggle are, of course, inherently uncertain, but I believe the basis for the claim that "all is lost" to be very weak. In fact I would argue that a dramatic political response to these developments is inevitable. Indeed, judging by the accelerating disintegration of societies and nation states around the world, it has already begun. The question is only what form this reaction will take. And here I believe that our main task as intellectuals

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<sup>1</sup> This paper is a revised and updated version of a keynote speech delivered to the International Conference "Globalization and Social Change" held at Research Center on Development and International Relations, Aalborg University, 15-16 May 1997. The paper is a comprehensive version of a shorter chapter to be published in Johannes Dragsbaek Schmidt & Jacques Hersh, "Globalization and Social Change", Routledge, London & New York, 2000.

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and as responsible, politically engaged citizens, is to counter the incessant claims that resistance is futile; to critically examine the claim that these processes enhance human welfare; to oppose all efforts to lock these policies in to international agreements that constrain democratic choices; and to continue to build and to articulate a vision of humane and superior alternatives.

## **THE GLOBAL LOGIC OF THE MARKET**

I begin with an obvious, indisputable point. Competitive market forces are amoral, unsentimental and enormously powerful. In arm's length markets, goods and services compete without reference to the social or human conditions of their production. In the process, they become commodities; socially disengaged use values. And, when their appearance and their performance characteristics (their "use values") are equivalent, the cheapest ones survive. The question of whether that low price was made possible by superior organisation, by better technology or by the more intense exploitation of labour, is of no concern to the market, unless people, acting through a political process, make it so.

The history of capitalism is a history of this struggle: the logic of the market, pitted against the efforts of societies and cultures to define, and to sustain, some ethically rooted, politically defined structures that can limit, and direct, the potentially overwhelming force of the competitive market. This struggle has been uneven across space and time, but over time there has been a powerful tendency to erode affective social networks and to create increasingly fragmented and instrumental societies. In this process, human beings gradually become "human capital;" mother earth turns into a privately owned factor of production; and knowledge and ideas are made into "private property" - for sale or hire to those with the ability to pay.

After WW II a particular set of circumstances had conspired to allow market forces to be harnessed to a remarkable degree. The memory of the turbulent twenties and the depression which was its legacy; the Second World War; the rise of the Soviet bloc; and the extreme political fragility of post-war Europe, had combined to usher in an era of remarkable pragmatism. The result was a world in which capital came to be socially rooted to a degree because it was tethered to nation states in many of which, full employment had become an overriding policy priority, for the time being. With capital being forced to accept politically negotiated compromises between itself, labour and "the state," the competitive market's drive for efficiency was forced to function more clearly within socially and politically defined limits and, to the surprise of some, this led to a long period of unusually stable and rapid growth and to historically unprecedented improvements in living and working conditions for the citizens of most capitalist countries. In this "Fordist model" of capitalism, stability and

rising consumption stimulated investment, which led to rising output and productivity. It was a virtuous circle, and it was real.

To economic liberals this did not make sense. To them, the post-war settlement, with all of its restrictions on the free flow of capital, was merely a “botched compromise;” (James 1996) a third best, hobbled and distorted capitalism, which had emerged only because of the unfortunate political realities of the day. With entrepreneurial initiative stifled; with workers empowered and protected; and with state bureaucracies and “unrealistic” social and environmental activists playing an ever-greater role in the policy process, efficiency and prosperity were surely doomed. Moreover, for the true believers, even the quarter century of prosperity that followed, was no reason to re-assess their beliefs. They merely suggested that this surprising outcome was due to fortuitous circumstances, especially to the need for widespread reconstruction after the war, though they failed to explain why previous wars had not led to such a benign outcome. Beyond this, they simply claimed that this prosperity could not, and would not, last and that, in any case, there would be even more of it if one allowed market forces a free reign. And, as the prosperity continued, and the memories of the twenties and thirties faded, this latter claim came to be taken more and more seriously, especially by those who did not understand that the neoclassical economic theory from which those conclusions were ostensibly derived, could not be applied to the real world in this way. Finally, when that prosperity did eventually falter, they claimed that this vindicated their claim that such a “managed market model” was impossible to sustain.

Ironically, they were assisted in this task by the emergence of the regulation school on the left, since their analysis seemed to corroborate the claim that this model had collapsed because it had become exhausted and unviable. Squeezed between rising wages and expectations on one hand, and a diminishing capacity to generate productivity gains on the other, it had necessarily been swept aside by the resulting crisis of accumulation. What was new about this analysis was the fact that it focused attention on precisely the same issues that were of central concern to those on the right, who had been waiting all those years for their chance to declare this model impossible. Now they could agree with this section of the left: wages were too high; profits too low; and productivity gains not high enough.

What was unfortunately lost sight of in the ensuing debate, was the main underlying reasons for the demise of the post war “social market” model. This was quite simply the fact that the rules and regulations that had tethered capital to the nation state, were first subverted, and then dismantled, often allegedly in order to allow flagging productivity levels and profits to be revived. In this

process, the post-war social market was destroyed just at the moment when it was poised to make the shift to the “leisure society,” that had been so widely anticipated and predicted. Such a shift would have implied that productivity gains would have been increasingly taken in the form of increased leisure, while consumption patterns would have become less material intensive, as demand shifted towards services and cultural activities.

Moreover, if that shift could have been combined with continued full employment, and with the political and social stability that this entails, it could have provided the material basis for the development of a genuinely constructive and benign relationship between the industrial and the less developed worlds. This is because a full employment growth path would have generated large investable surpluses, while political stability and economic security would have made it easier for people to agree to the transfer of substantial amounts of capital to the developing world on a grant basis, as under the Marshall Plan. The recipient countries could then have used those resources to build productive capacities that were primarily oriented to rising domestic demand, instead of being trapped in their present situation, in which they are perpetually required to restrain domestic demand in order to pay for the very costly capital that was made available to them. Moreover, if the implicit acceptance of a lower rate of normal profit in the industrial world<sup>1</sup> had gone hand in hand with a reduction in the material intensity of consumption in the industrial countries, then it would have been possible to avoid the environmental crisis that will surely arise if the developing world simply follows in the footsteps of the industrial world while the latter remains wedded to its absurdly wasteful and frequently irrational patterns of growth and consumption.

But this option was closed when capital was allowed to slip the leash that had tethered it to a degree in the early post-war period. The mechanisms through which this happened have been well-documented (Bienefeld 1982; Brett 1985; Lipietz 1987; Helleiner 1995; James 1996). The explosive growth of the Eurocurrency markets; the aggressive US policy response to its increasingly beleaguered economic position in the early seventies; and the oil crisis, were linked to create a lethal mixture that blew the post-war compromise clear out of the water. By the end of the seventies the world had been turned inside out. Capital had been returned to a position of clear dominance and the lessons of history had been re-written by neoliberals. The lessons that had underwritten the “golden age,” along with the policies that had produced it, were relegated to the scrap heap, allegedly discredited, along with Keynesian economic policy, by stagflation. The new neoliberal lessons of history, incredibly redefine the “golden age” as being the period of the gold standard, around the end of the nineteenth century, and make no reference to the turmoil of the twenties when

drawing the lessons of the thirties. Moreover, they almost entirely disregard the demonstrated potential of unregulated markets to generate serious speculative instability, and to polarise and to destabilise societies. These fatal flaws are simply treated as minor blemishes that can be fixed by the even more radical liberalisation of markets, and especially those for labour, pollution rights and information (James 1996).

It is surely ironic that the protagonists of this brave new neoliberal world view, who love to talk about the unprecedented novelty of today's technologically driven and irreversible process of globalisation, should offer us the nineteenth century as their vision of the golden age, and try to pass off the utterly discredited economic theories of the twenties as their "new" contribution to theory. Moreover, under these circumstances, it borders on the ridiculous that it is the left that is continually accused of being wedded to "old ideas;" especially when too many on the left have unwisely abandoned a lot of important "old ideas" that would have served them far better than the murky pronouncements of post Fordism. But, unfortunately for the left, all of this matters less than it should, since it is not those with the most persuasive arguments who succeed in the real world, but those whose power is enhanced by the changes occurring in that world.

In this sense, there is no doubt that victory has gone to the right, for the time being. By the end of the eighties the nationalist upsurge in the Third World had been well and truly beaten back, disciplined by debt and by an increasingly aggressive and single minded international system, willing to enforce the logic of the market with a degree of militancy and arrogance that had not been seen since the days of nineteenth century imperialism - their new "golden age." The "evil empire" has also been dismantled, and debt played a major role in that process, as well. And the nineties have witnessed an intensification of the attack on working people, even in the industrial world; an attack that began in earnest in the seventies and was reinforced in the eighties when escalating real interest rates allowed ballooning public sector debts to become a primary weapon in the assault on the welfare state and on gains made by the working class over the previous quarter century. A London based financial analyst described this assault very effectively and very accurately in 1993 when he replied to a journalist's question by suggesting that it was important for people to understand that "global financial markets are on a religious crusade to roll back social democracy." (Globe and Mail 1993)

And so they are. Nothing would be more foolish or naive than to think that these financial markets are not political because they are "simply concerned with rates of return." The truth is that those rates of return are closely linked, especially in



the short run, with the demonstrated willingness of governments to put the interests of bond holders first. And that is an eminently political matter; and it is why financial markets often react quite disproportionately to any indication that a government may be wavering in its allegiance to the “sound economic policies” that they favour and demand, even though they will frequently acknowledge that those policies may not be in the long-term interests of a country or a society. Indeed, individual investment managers will often say that such larger questions are “none of their concern.”<sup>2</sup>

So what has the victory of the neoliberals produced? Has it produced the stability, efficiency and prosperity that its advocates promised? Of course it has not. It has produced results that strongly confirm and corroborate the fears that had led the architects of the early Bretton Woods system to be so cautious and to design such strong safeguards against speculative flows of short-term capital; against the excessive volatility of interest and exchange rates; and against the excessive deregulation of markets, in general. Their fears that failure to do so would once again lead to explosive and dangerous contradictions in the world economy have been amply justified. Economic growth has once again, come to be associated with sharp increases in income inequality; with rising economic insecurity; with a financial sector that is increasingly divorced from the real economy; and with speculative bubbles that inflated and collapsed with awesome regularity, and with devastating consequences for millions of people. And in the process, the rights of working people and of citizens have come under sustained attack everywhere as the “icy waters of commercial calculation” rise inexorably, driven by voracious financial markets that constantly extend their dominion by assigning private property rights to ever more diverse aspects of life, from life forms, to ideas, to pollution rights.

The results are truly disturbing, especially when they are compared to the high hopes of the sixties, or to the stridently confident predictions of the mainstream economists of that day. There is no leisure society; no four day work week; no increase in economic, social or political security. Quite the opposite. Regular employment is increasingly treated as a luxury that we cannot afford. The social wage is being eroded everywhere, and the attack on public pensions has become a relentless, global campaign. In the US, real wages are below their level of 1973; and an Index of Social Health that has been calculated by Fordham University for many years, and that contains 16 variables (including unemployment, income inequality, food stamp coverage, child abuse, teen suicide, etc.), has fallen steadily and dramatically, from 73 in the seventies (under Nixon/Ford), to 43 by the end of the second Reagan presidency, to 38 by the end of the first Clinton term (The Nation: 11 Nov. 96).

A recent Canadian study of the incidence and nature of poverty, found a particularly big increase in poverty among people who are in work, which is also the dirty little secret of the US labour market, that is now, quite incredibly, held up by the OECD as a model for Europe to follow. The truth is that those low unemployment rates obscure the fact that there are very large numbers of discouraged workers, and that the number of “working poor” is very large and rising. Canada does not even have the low rates of unemployment, but the problem of the working poor is still moderated by the existence of government transfers, although these are increasingly under attack. Thus, a recent comprehensive study of the problem, concludes:

Canada’s job market is less able now than it was a decade ago to offer economic security to people in low-income families, many of whom already work. The reasons are familiar - too few jobs and low wages in many of the jobs the poor hold.... The marketplace as it runs now can’t generate enough well-paying jobs for the poor. So without government transfers (many of which are being cut) even the working poor would be poorer.<sup>3</sup>

Moreover, these problems look far more serious when they are viewed from a generational perspective, as the costs of the recent reversals have been disproportionately borne by the younger generations, who have been systematically excluded from stagnant job markets in which segments of the older generation have managed to maintain a foothold, protected in part by “last in, first out” rules. Although that is now beginning to change, as downsizing affects more people at more senior levels in both business and government, the skewed nature of the process as it has unfolded to date is graphically reflected in both Canada and the US whenever real income statistics are stratified by age. The results, invariably present a disturbing picture, showing the average real incomes of younger people falling sharply, while those of older workers often continue to rise right to the present. And when one stratifies the population by education and skill, it is those with less education and skill who are seen to have borne the brunt of the reversals. While this does not mean, as is sometimes suggested, that the problems of the younger generation could be resolved by extending the same degree of insecurity to all, this asymmetry may help to explain why the older generation, and the more highly skilled and educated, have not put up more resistance to these reversals. But these groups had better “wake up and smell the coffee,” since the definition of “unskilled” is steadily expanding, and since downsizing is reaching ever higher into the senior ranks of management and administration.

Nor is this attack on labour easing, as one might have expected if it had merely

been imposing “short-term pain for long-term gain,” as some had suggested. In fact, the attack is intensifying even though those long-term gains are proving resolutely elusive; and even though there is now significant evidence to show that these policies are often misguided and destructive.<sup>4</sup>

The truth is that the attack on labour was never primarily motivated by a desire for greater efficiency; much less by a desire to enhance global welfare. It was about income redistribution; about enhancing the returns to capital; about raising real interest rates to historically unprecedented levels; about underwriting, and validating, speculatively driven increases in stock and other asset prices. And the result was a powerful and pervasive downward pressure on real wages and on the conditions of labour in large parts of the developed and the developing world, even including Asia in the wake of the crisis of 1997. In the US., ostensibly the “most successful” industrial economy, the situation was summarised as follows by Business Week in October of 1996:

Business executives are running scared from intense competition at home and abroad, and workers justifiably fear layoffs. The latest numbers show that 12% of college educated male workers lost their jobs between 1993 and 1995, a higher rate than in the 1980s or even the early nineties. Americans are living with a combination of growth and uncertainty they’ve never seen before the most vibrant areas of the economy...are precisely those with the most turmoil.... The shift to a high-risk society has been accelerated by the past 20 years of government action. Free trade, deregulation, and open immigration...yield faster growth and higher living standards but add to economic uncertainty.

(Mandel 1996: 86)

This captures the essence of the present situation rather well, except for the glib claim that these changes “yield faster growth and higher living standards,” which is wholly unsubstantiated and quite incompatible with the evidence. The truth is that the sluggish growth rates of the past twenty-five years compare very unfavourably to those achieved during the previous quarter century; the world’s fastest growing economies in Asia were generally statist and highly regulated throughout the seventies and eighties when they were the engines of the world economy; and the endemic increase in the insecurity of work which is so effectively described in this Business Week article, was accompanied by stagnation and decline in real wages for most working people in that country. Indeed, this is presumably why the article ultimately falls back on the claim that these changes have to be accepted because they are inevitable, in that: “the damage done by economic uncertainty is real. But the clock cannot be turned back to the economy of the 1950s and 1960s.” (Mandel 1996: 94)

But one is bound to ask why this “clock cannot be turned back?” Or whether that conclusion is completely unrelated to the question of where this process is heading? What if this “damage done by economic uncertainty” were to continue to escalate? Would there not come a point at which the question would have to be addressed? Indeed, even among conservatives such simplistic conclusions have begun to be called into question for some time now. So, in 1994, *The Economist* expressed its grave concern about the explosive increase in income inequality that had accompanied the neoliberal revolution around the world, but especially in those industrial countries in which it had been espoused most enthusiastically.

Income inequality in America and Britain are greater than at any time in the past fifty years. The social consequences of this change worry many.... It is no coincidence that the biggest increases in income inequalities have occurred in economies such as those of America, Britain and New Zealand, where free market economic policies have been pursued most zealously.... In 1992 the top 20% of American households received 11 times as much income as the bottom 20%, up from a multiple of 7.5 in 1969.... Britain too the gap between rich and poor has been widening...the Gini coefficient rose from 0.23 in 1977 to 0.34 in 1991, a bigger jump than in any other country.

*(The Economist 1994: 19)*

This 50% increase in Britain’s Gini coefficient over such a short period is simply stunning. And the same could confidently be said about CEO compensation levels in the United States, which have literally spiralled out of control.

J.P. Morgan, seldom portrayed as a radical, maintained that no corporate chieftain should earn more than twenty times what his workers were paid. Things have changed since Morgan’s day. By, 1980, when Ronald Reagan was elected to the White House, the typical C.E.O. of a big American company was taking home forty times the annual earnings of a typical worker on the factory floor. Reagan, it will be recalled, didn’t think that this reverse redistribution had gone far enough – “We’re the party that wants to see an America where people can still get rich,” he told one Republican gathering – and by the time he left office even more had been done to alleviate the suffering of C.E.O.s. In 1990, they took in about eighty-five times as much as factory workers.

Still, the rewards that senior executives enjoyed during the Reagan era

were mere *hors d'oeuvres* compared with what was to come. Between 1990 and 1998, according to a new study published jointly by the Washington-based Institute for Policy Studies and the advocacy group United for a Fair Economy, the annual “compensation” of C.E.O.s at large firms rose from \$1.8 million to \$10.6 million – an increase of almost 500 per cent. Workers’ wages also rose during that period, but their rate of ascent barely kept pace with inflation. Last year, big-league C.E.O.s pocketed, on average, four hundred and nineteen times the earnings of a typical production worker.

(Cassidy 1999: 32)

But even this does not capture the full extent of the social revolution that is occurring as the icy waters of commercial calculation rise inexorably higher. Not only is work becoming more stressful, insecure and demanding; not only are most peoples’ wages and salaries stagnating or falling; not only are public services being systematically eroded; not only are the rich appropriating resources beyond all reason or understanding; but the power of this increasingly concentrated wealth is being extended ever further into every nook and cranny of our personal and social existence. In time, everything will be “for sale” and in a world of increasingly unequal incomes that will further sharpen the spur of poverty – and the desperation of the poor.

But in this new world of commercial calculation, this growing army of desperate, impoverished citizens does not pose an ethical dilemma, but promises wonderful new investment opportunities in the “security industry.” There is no ethical problem so long as one believes that “there is no alternative;” that “the system” maximises overall welfare; and that the poor are personally responsible for their plight in this entrepreneurial world of opportunity. And the rich generally find it easy to persuade themselves that these self-serving platitudes represent deep philosophical truths.

At the same time, the rich have been quick to spot the enormous investment opportunities implicit in the arrival of the “insecure society,” especially once the “prison industry” was privatised. And so the “new age” entrepreneurs have seized the enormous possibilities of exploiting fear and insecurity for profit - selling insurance, “secure residences,” dead bolts, security systems, hand guns, get rich quick lotteries and financial schemes – and, of course, shares in the new private prisons that sprang up to “warehouse” the explosively growing prison population.<sup>5</sup> These have been the growth industries of the eighties and nineties, and they appear to have a bright future, especially since the freedom to exploit these opportunities continues to be expanded in a number of directions.

Perhaps the most significant development on this front is the push to legalise the commercial exploitation of prison labour in the United States. From a “new age” perspective, and from that of the prison lobby, the issue is, once again, clear-cut. Prisoners should not burden the tax-payer; they should pay their own way; and, in a world of private prisons, this means that the prison corporations should be free to use, or to sell, that labour power in the market. Efficiency demands it; profitability demands it; and the shareholders demand profits. The moral dilemma that arises when an increasingly unequal society creates powerful lobby groups – and armies of faceless investors – who profit from the incarceration of people is easily ignored – or trivialised by saying that it merely required “adequate regulation.” But the dilemma is real – and it goes to the heart of the question of how societies are to set effective limits to the logic of the market in an increasingly unequal, competitive and “global” world?

In the United States, these developments have progressed to the point where, in certain states like Texas, private prisons are now the main employers in many small towns, which further extends the potential for poisonous conflicts of interest, especially in racially divided, highly unequal communities providing little or no social welfare support for indigent population. The proliferation of private, for profit, prisons has enabled the powerful lobby which needs more prisoners to improve “bed occupancy rates” and profits, giving it a powerful material interest in promoting tough new sentencing regimes in a country that already has a disproportionate prison population composed largely of poor members of minority groups.<sup>6</sup> But the conflicts of interest do not end there. In California, a judge has been convicted for taking bribes from a prison corporation, in return for handing down “tougher sentences” (Gragg 1996: 50-51); and everywhere the pressure to allow prison labour to be used for commercial purposes is clearly growing.

For profit prisons were common in America until prison-labour abuses in the South led to their outlawing by 1925. But in 1984, the federal government contracted the Corrections Corporation of America to operate an immigration detention centre in Houston. By the end of 1997, 102 private prisons will operate in the US..... But as prisoners become corporate commodities the opportunity for abuse grows. Since 1990, thirty states have allowed prison labour to be contracted out to private companies that split the profits with the government and victims. Inmates receive little or no wages and have virtually none of the protection afforded workers on the outside.... Sold to troubled towns as a “clean industry” that creates an “inflation proof economy,” privatized prisons are spreading across the American landscape with little or no national debate.  
(Gragg 1996: 50-51)

These developments illustrate the growing difficulty of setting limits to the ability of people to use markets to profit from human insecurity, human suffering and human bondage. And they should serve as a reminder that the market itself sets no such limits. Nor is the market a “neutral,” or a “natural,” institution. It exists within a politically and a socially constructed world and it is pure folly to think that it can be left to determine the shape of that world.

These developments are not desirable; not ethically defensible; not sustainable; and not efficient. They reflect a desperately unhealthy situation in which political power is being used to allow redistributed wealth and income to be appropriated and concentrated on an unprecedented scale. And, left unchecked, they must, in time, trigger a political reaction that will either lead to a dramatic reversal, or to an uneasy peace, in which increasing levels of repression contain an ever more alienated mass of marginalised people.

These lessons have been learned before, most recently in the twenties and thirties, and it seems that we are destined to learn them again. The lessons are that markets are powerful and benign instruments for diffusing power and for allocating productive resources, so long as they are embedded in relatively stable, coherent societies capable of curbing their centrifugal tendencies, and their tendency towards “instability and fraud” (WB WDR 1989); capable of setting ethically, socially and politically defined limits to the search for competitive advantage; capable of nurturing and protecting the social values and networks whose existence allows contracts to be enforced at reasonable cost; and capable of protecting the political process and the media from complete domination by wealth and economic power.

The quarter century after WWII brought us the “golden age” because the experience of the twenties and thirties had generated political forces that allowed markets to be so embedded. And the early Bretton Woods agreement, by providing for extensive capital controls, forced capital to have a nationality, and therefore to negotiate and deal with those political forces at the national level. The result was a remarkably sustained, stable, dynamic and inclusive process of growth and development. Growth was rapid and sustained and its benefits were widely shared – in the form of rising real wages, improved working conditions and strengthened social services. Profits were high though rates of profit tended to decline over time, as they should in a society in which capital is becoming relatively abundant (Keynes 1933).

Moreover, these lessons of the golden age have been further confirmed by the results of the subsequent neoliberal revolution, which have been briefly

described above. Having become effectively disembodied, markets have proven to be extremely divisive and unstable; income and wealth are rapidly polarising; growth and investment levels remain low, stifled by uncertainty, the high cost of capital and the presence of enormous mountains of accumulated debt; and, for most people, the quality of life is being undermined by increasing instability and stress at work, stagnant or falling real wages and incomes, and the systematic erosion of their claims on society and their rights as citizens. And, as in the twenties, these developments are fuelling a dangerous process of political disintegration as ethnic nationalisms fill the void left by the collapse of coherent states.<sup>7</sup>

## **DEVELOPING COUNTRIES AND TRANSITION ECONOMIES: SOME VICTORIES, MORE BROKEN DREAMS**

If the neoliberal revolution is polarising and destabilising the industrial world, it should come as no surprise that it has exacted a high price in most of the rest of the world, with Sub-Saharan Africa (SSA) and the transition economies of the former Soviet bloc being the worst affected, though Latin America as a whole, has also paid a high price. Asia, and especially East and Southeast Asia, has been the exception, having enjoyed rapid growth and development throughout the eighties and early nineties. However, the crisis that erupted in 1997 has called even its future into question.

### **Africa's Predictable Tragedy**

For SSA the past twenty-five years have been particularly devastating, as weak and unbalanced economies were exposed to increasing competitive pressure and to demands for institutional change that often far exceeded their political, institutional and technological capacities. Unable to service their accumulated debts, or to persuade their creditors to ease those burdens significantly, they found themselves trapped in a world of endless austerity, and increasing instability; a world that stifled growth and investment, destroyed the viability of past investments (especially in infrastructure), deepened social and political tensions and gradually eroded the social fabric. And, in an increasing number of cases, this process eventually passed the point of no return when societies face a catastrophic collapse into anarchic instability.

But such disastrous outcomes should not have come as a surprise. The risks of applying the simplistic formulations of neoliberal “mono economics”<sup>8</sup> to this fragile region, were evident even in 1981, when the World Bank’s “Berg Report” first elevated them to the status of “official” policy. The claim was that SSA’s problems were primarily due to misguided state policies which had prevented market forces from ensuring rational and efficient patterns of resource allocation; and that these problems could be solved by shifting power from



states to markets and by opening the economies much more fully to competitive pressures from abroad. But such “text book advice”<sup>9</sup> lacked credibility under SSA’s actual circumstances, as I had tried to explain in a 1983 review of the “Berg Report.”

the document as a whole [is] fundamentally wrong in its analysis; self-serving in its implicit allocation of responsibility for current problems; misleading in its broad policy prescriptions; and totally unrealistic both with respect to the social and political implications of its ‘solutions’ and with respect to its assumptions about real aid flows, price and market prospects for African exports and the robustness of Africa’s struggling institutional structure.

It is both arrogant and meaningless for the Bank to assert in that context that...the way forward lies through a greater concern with technical expertise and a greater reliance on the market. Such advice cannot be followed for any length of time under current circumstances because the social and political consequences...would be so dramatic that the policies would be devastated by the political whirlwinds which would be unleashed. As in the past these domestic political responses could then be blamed for the disasters which follow, rather than being seen as more or less direct consequences of the acceptance of the(se) externally designed policy prescriptions.

(Bienefeld 1983: 18, 22)

By the late eighties, it was becoming clear even to the Bank that SSA was not doing well. In fact, the region was clearly regressing even in purely economic terms. According to the Commonwealth Secretariat, “per capita incomes fell by over a quarter” between 1980 and 1988 (*Commonwealth Secretariat* 1989: 23), and the World Bank’s assessment was similarly bleak.

In the twenty-two debt-distressed, Sub-Saharan African countries per capita consumption dropped by about 3.2 percent a year and investment by 2.6 percent a year between 1980 and 1986. The debt crisis of the 1980s thus dealt a double blow to the more vulnerable developing countries. Reductions in per capita income lowered economic welfare immediately, while large cuts in investment threatened the potential for future growth....

Moreover despite these drastic retrenchments, the low income African countries saw both their debt/GDP and their debt service/export ratios increase steadily between 1982 and 1987, the former from 48 to 76

percent and the latter from 14 to 35 percent.

(World Bank 1988: 30, 31)

Worse still, the region's future development prospects were being blighted by low investment rates and a rapidly deteriorating infrastructure. And there was little evidence to suggest that this pain was being endured for good reason. The World Bank itself was forced to conclude in 1988 that "in the low income Adjustment Lending countries...the hoped-for switching and growth-augmenting effects of adjustment lending are not apparent." (World Bank 1988) In short, even for those who firmly believed in the neoliberal policy regime, it was increasingly difficult to avoid the conclusion that these policies were not solving SSA's problems.

But true ideologues are not easily swayed by the evidence. They can always choose to believe that those apparent failures are the result of inadequate implementation, insufficient time or unfortunate and unpredictable "exogenous" developments. Or they can claim that the outcomes would have been even worse in the absence of "their" policies, which allows the policies to be declared a success, irrespective of the actual outcomes. And it is on these grounds that the advocates of neoliberal globalisation have continued to defend their policy prescriptions for SSA, though not without expressing "deep concern" at the disappointing "early" results. And, although the Bank and the Fund have recently abandoned the claim that the "magic of the market"<sup>10</sup> could restore SSA's development prospects even if they were required to repay all debts in full, their belated acceptance of the need for significant debt relief<sup>11</sup> is actually being used to further intensify their promotion of the neoliberal policy regime, in that only countries that commit themselves totally, and more or less irrevocably, to those policies, will be eligible for such debt relief.

The Bank's commitment to its orthodox policies has, therefore, remained broadly unchanged despite the persistence of disappointing results; results which led its Chief Economist to declare in 1988 that:

We did not think that the human costs of these (adjustment) programs could be so great, and economic gains so slow in coming.

(O'Brien 1988)

Elsewhere, that same evidence led the Bank to acknowledge that "a longer time perspective is required for broader institutional changes" like those implied by its structural adjustment policies<sup>12</sup>. But such magnanimous admissions of fallibility are not much comfort to those suffering the "short-term pain" and waiting, in vain, for the "long-term gain". They are not much help, because: they

leave the basic policies unchanged; they leave the duration of the “short-term” completely unspecified; they obscure the uncertain and experimental nature of those long awaited institutional changes; and they ignore the very real risk that an excessively long or disruptive transition could destroy the promised long-term gains by undermining social and political stability, with potentially disastrous consequences. And such complacency is quite inexcusable when dealing with a region like SSA where such disasters are not merely hypothetical possibilities.

Behind the scenes, in the second half of the eighties the World Bank did become aware of the fact that time did not appear to be on its side in SSA. Although the counter-factual claim that things might have been even worse in the absence of its policies, might allow it to defend those policies in academic circles, this claim did not travel well in the real world where the people and the policy makers of Africa actually lived. Here the dominant facts were that, in most cases, these policies were not delivering what they had promised, or what they had set out to achieve. And, in more than a few cases, they were worsening economic imbalances, deepening social divisions, and increasing political tensions.<sup>13</sup> And these realities steadily undermined their credibility, a point that was highlighted when the government of the Ivory Coast, which had until then been one of the model pupils, abandoned those policies while issuing a public statement stating:

that the International Monetary Fund and the World Bank austerity measures and economic adjustment programs that it has obediently implemented since 1981 have brought little benefit and much pain.

The Government feels that it has exhausted both its patience and the range of administrative measures recommended by the IMF and the World Bank. ‘We now consider that the indefinite continuation of austerity on such a scale would endanger the political and social stability of our country’ Abdoulaye Kone, Economy and Finance Minister told the country’s creditors.

*(The Toronto Globe and Mail 1988)*

Some response was clearly needed to restore the credibility of the orthodox policy package under these circumstances, and this became a central concern within the World Bank. Its response was very effectively described by Ramgopal Agarwala, the senior World Bank economist who was eventually chosen to lead the team that was created by the Bank in 1987, to resolve these growing uncertainties.

During the second half of the 1980s...the Bank's management sensed donor fatigue setting in as a reaction to the continuing African woes and repeated calls for more assistance. The international community was in need of reassurance that efforts to help Africa were effective and that there was 'light at the end of the tunnel.' The view, in the Bank, however, was that this possibility could only be offered as a long-term project.

Thus was born the idea of a long-term vision for Africa, and the Bank initiated a study to demonstrate that, despite some major problems in the short and medium term, Africa could have a reasonably optimistic long-term future if appropriate policies were followed and external assistance made available at the appropriate level. The staff team assembled for this study struggled desperately to find 'the light at the end of the tunnel,' especially as the prospects for rapid economic growth seemed unrealistic over the medium or long-term.<sup>14</sup>

(Agarwala and Schwartz 1994: 3-4)

In other words, the Bank clearly understood as early as 1987, that there was no chance that its policies could restore growth and development in SSA, at least not so long as full repayment of the debt remained a non-negotiable demand. Its response was to commission a study "to demonstrate that... Africa could have a reasonably optimistic long-term future if appropriate policies were followed." And those "appropriate policies" were, of course, its standard adjustment policies. In short, the study was to defend those policies against their critics by "demonstrating" that they remained the best option and would yield major gains "in the long run."

However, in order to give the study credibility it was decided that it should use a participatory approach. "Consultations with the Africans should not be perfunctory," and Bank staffers were urged to "seek inputs from Africans and not just [to] discuss with them the nearly finished product." (Agarwala and Schwartz 1994: 4) Unfortunately for the Bank, this strategy backfired because the credibility of their policies had, by now, sunk so low, that they simply could not survive this "participatory process." Indeed, this process gradually persuaded the Bank's own team that those orthodox policies were not working, and were not going to work, in SSA.

The report's orientation...was influenced in a fundamental way by the oral and written inputs of Africans and the donor community. One could even suggest that the participatory process brought about a veritable shift

in perspectives and in the paradigm underlying the report's analysis.

(Agarwala and Schwartz 1994: 10)

At the end of the day, the team concluded that the Bank's adjustment policies were basically misguided and inappropriate for SSA.

As the participatory process...started some doubts about the efficacy of adjustment in Africa began to emerge.... But, ultimately it was the accumulation of anomalies, the realization of just how deep the crisis was, and the possibility that an alternative paradigm could explain the situation better...that opened the minds of the report's team...after ten years of stabilization...it was becoming clear that 'prices and markets could not deliver' without a solid domestic institutional base for governance and development management.

(Agarwala and Schwartz 1994: 13, 16, 26)

Moreover, it was acknowledged that there had been "anomalies...from the very beginning" that had called the validity of these policy prescriptions into question when they were first introduced, but in spite of those uncertainties, the "Bank was fully geared up to promote [its orthodox version of] adjustment lending" throughout the eighties, making its assistance available "mainly to nations which were judged to be following policies the Bank considered appropriate." (Agarwala and Schwartz 1994: 12)

Ultimately these conclusions were framed in far more general terms – and it is in this form, that they speak most directly to the argument that is being developed in this paper. The team's rejection of the orthodox policies was presented as a "paradigm shift" that was made necessary because there were now too many "anomalies" that the existing paradigm could not explain – or comprehend.<sup>15</sup> And, although a new paradigm would take some time to emerge, the need for one was now incontrovertible; and, according to the team, it was most likely to be built around the idea of "the social market."<sup>16</sup>

The crisis in Africa and Latin America, and more recently in the former Soviet Union and Eastern Europe, may in time lead to the emergence of a new paradigm or a synthesis between the Keynesian and neoclassical paradigms. Some elements of such a synthesis exist in the workings of the social-market economy in Germany, the Nordic countries, the Netherlands, and the experiences of Japan and Korea. Some more time will probably have to elapse before the crisis deepens, anomalies accumulate, and a new paradigm is advocated by a persuasive and powerful proponent.... The growing interest in the East Asian 'miracle' will lead to further questioning of the existing paradigm and the search for

an alternative paradigm is likely to continue.

(Kuhn 1970: 11, 12)

Unfortunately, these strong conclusions were not clearly reflected in the report that the Bank ultimately produced (World Bank 1989). Although that document did raise some critical questions regarding the orthodox policy prescriptions, and although it did cause some controversy by suggesting that there was an urgent need to rebuild SSA's rapidly deteriorating infrastructure and to reverse the process of social polarisation, it also explicitly endorsed the Bank's basic policy stance on more than one occasion. While such discrepancies are not unusual for the Bank,<sup>17</sup> in this case it seems that they arose largely because the team chose to "pull its punches" for strategic reasons. This is how the former team leader described that process in a paper written some years after its appearance:

Partly for bureaucratic reasons, the issues were not spelled out [as] fully in the report as they have been here. The unorthodox findings...could only be presented in a low-profile manner, more as an undertone than an open challenge. The intellectual 'ocean liner' of a large international bureaucracy cannot be turned around overnight.

(Wade 1996: 27)

The tragedy is that the ocean liner did not turn. The Bank's next report on SSA made few references to those critical conclusions, and simply argued that the region's experience was compatible with the Bank's orthodox policy prescriptions. It would seem therefore that ideology still overrides the evidence, and that the commitment to the neoliberal policy regime is driven largely by power and interests, not by evidence.

### **THE LATIN AMERICAN "RECOVERY:" SHORT-TERM GAIN FOR LONG-TERM PAIN?**

The Latin American story is rather different. Having suffered dramatic reversals in the eighties, its economies did generally recover some ground in the nineties and this has led them to be widely hailed as great success stories in certain quarters. But their "success" has been very uneven – and remains extremely precarious. It is most apparent if one looks at foreign capital flows and the growing financial sectors; but it is not at all apparent when one looks at wages, poverty and living conditions for the great majority of Latin Americans. But because the eighties were so difficult, because Latin American societies have long been notoriously polarised and because significant minorities have managed to benefit substantially from the neoliberal policy regime in every country, these policies have a much stronger base of support within Latin America itself. These are, in other words, "home grown" policies to a much

greater degree, although the international institutions do provide powerful backing and reinforcement.

On balance the evidence from this continent lends further support to the claim that the neoliberal policy regime is deeply divisive, endemically unstable and ultimately unsustainable. And, although that experience also shows that under certain circumstances, these policies can have a positive impact for a time, they will not promote the emergence of politically stable, socially integrated, prosperous societies in which the quality of people's lives can be expected to improve steadily over time. In the longer run, they can only promise a future of endemic instability, extreme inequality, pervasive social conflict, steady environmental degradation and uneven growth. In other words, the short-term pain for long-term gain argument that is so often used to justify continued implementation of these policies in the face of disappointing results needs to be turned on its head. In fact, in those few cases where the short-term results are relatively positive, we need to understand that we are almost certainly dealing with short-term gain, for long-term pain.

Chile is, of course, the Latin American "success story" that is most widely touted and there is some basis for this positive response. It has grown relatively rapidly; it has been relatively stable for more than ten years; and it has dealt relatively effectively with its social problems. But the lesson of Chile is not therefore that neoliberal policies work. The lesson is that when those policies are applied in a society that has a strong administrative infrastructure, a political balance of forces that requires it to pay some attention to social welfare issues,<sup>18</sup> a willingness to exercise control over foreign capital movements,<sup>19</sup> and a resource base and infrastructure that were very attractive to international capital at the time. But it is important to understand that most of these pre-conditions were the legacy of earlier policy regimes, and that the neoliberal regime itself actually tends to undermine those same conditions. It tends to impair administrative structures, undermine morale in the public service, foster tension and mistrust in communities, put less priority on infrastructure, privilege the interests of capital and impair a national society's capacity to control capital vis-a-vis the national interest.

In the rest of Latin America, only Costa Rica had similarly positive pre-conditions for a neoliberal policy regime. For the others, the disastrous eighties have been followed by a roller coaster ride in the nineties, as massive quantities of speculative capital have once again flooded into the key countries of the continent, creating the illusion of prosperity while buying up resources, utilities, financial institutions, industries, politicians, policies. Meanwhile the underlying social and political tensions have continued to rise in most places, as the income

inequality has grown; as informal sectors have grown explosively; as work has been casualised; as economic and social insecurity have increased; and as wages have lagged far behind other incomes, and often behind the cost of living. A recent ILO press release summarised the developments in this continent very effectively.<sup>20</sup> The statement cited a new ILO report which acknowledged that “reforms and modernization [had] succeeded in taming rampant inflation and prompted a return to growth,” but then went on to warn that the social impact of these gains was giving rise to growing concern because:

The jobless rate of Latin American and Caribbean economies rose steadily in the 1990s and job insecurity increased as the modern sector of the economy virtually ceased to generate employment. The bottom line, says the ILO report:

Economic growth and price stability have not produced a significant improvement of the employment situation or of wages. ...the burden of adjustment has been heavily borne by the work force. The modernization of the economy is coming about as a result of casualisation of labour relations, often with disastrous social consequences for workers. Workers' buying power fell dramatically during the past decade, dropping to 27% below what a salary bought in 1980 for minimum wage earners. The purchasing power of minimum wages fared much worse ...the present minimum wage in Latin America stands 27% lower than at the beginning of the 1980s.

(ILO 1999: 1- 4)

In short, we are dealing with a pattern of growth that is both unethical and unsustainable because it fuels inequality, social instability and the deterioration of working conditions. And to make matters worse, the resulting increase in uncertainty, together with the endemic need to restrain domestic demand in highly indebted economies, often leads to a deterioration of the social and economic infrastructure as well as to low levels of productive investment and low rates of productivity growth.

Of course, as always, one can argue that these “costs” represent short-term pain for long-term gain. Thus, Mr. Somalia, the ILO's Director General, in presenting the above report went out of his way to endorse the basic orthodox policy stance, referring to Latin America's “tremendous strides in modernizing economies, while maintaining steady growth and overcoming inflation” and then going on to accept that “in an open international system, the struggle for macroeconomic stability and increased productivity was necessary.” It is only within this context that he calls for a greater recognition of the fact that “the provision of decent work and social protection” which he describes as “the



greatest guarantors of social progress and the best means of consolidating the gains of the past decade.” The trouble is that those gains accrued very disproportionately to the continent’s upper income groups and to international capital. And the lack of social and human progress that Mr. Somalia is deploring would appear to be an endemic feature of the current neoliberal incarnation of an “open international system.” Moreover, he might have noted that the “struggle for macroeconomic stability and increased productivity” is apparently not being won, despite the high costs being imposed on so many societies.

Mexico’s experience provides some insight into these relationships. In the early nineties, after its debts had been substantially restructured, it began to attract massive capital inflows especially once it had firmly “locked in” the neoliberal policy regime by entering the OECD and NAFTA. At the time it came to be celebrated as the quintessential success story; a model to be followed by others who wished to “develop” rapidly. Few remembered the very similar hype and euphoria that had accompanied the “success” of so called NICs (Newly Industrialising Countries) like Mexico and Brazil in the late seventies. But people should have remembered. They should have remembered that growth and “sustainable growth” are not the same things. Many were therefore very surprised when the peso crisis rudely interrupted the celebrations in 1994. But because the financial situation was stabilised relatively quickly, and the worst fears of investors did not materialise, the episode was soon transformed into “evidence that the international financial system was now very robust.” And Mexico went back to being a “success story” of sorts, in financial circles. However, just as it was necessary to examine the basis of that earlier growth, so it is necessary to examine the basis of Mexico’s turn around. And when this is done, it is more difficult to sustain the claim that “all is for the best” south of the US border.

The peso devaluation of December, 1994, and the ensuing capital flight and stock market crash, plunged the Mexican economy into its deepest depression since the 1930s. Within two months of the devaluation, the value of the currency had declined by more than half; within four months the level of unemployment had doubled; inflation jumped from 7% in 1994 to 52% in 1995; and the gross domestic product (GDP) had declined by 6.9% at year’s end. The economic crisis saw the collapse of the country’s internal market, the virtual disappearance of credit for small and medium-size businesses, a dramatic contraction of formal employment and an alarming growth of poverty. Twelve months after the peso debacle, an estimated 75% of Mexican families could not afford the ‘basic basket’ of goods and services considered necessary to bring a family above the official poverty line. 1995 was not a happy year.

1996 saw a halt to the decline, and the beginning of what is now being touted - especially to foreign investors - as a recovery. '...But [this]... 'recovery' is doing nothing to improve living conditions in Mexico. Real wages continue to fall, formal employment continues to be hard to find and the rate of poverty hasn't budged.... The opening of the economy in the 1980s and the declining real incomes of the population rapidly eroded the market for domestic producers.... Without any adjustment or modernization program, and with soaring interest rates and a lack of credit, Mexican firms simply could not compete with the less expensive products...being imported from Asia.... The assault against domestic producers extended to other manufacturing areas, and dramatically to the rural economy. By the late 1980s, small farmers...found that they could no longer compete with the growing volumes of imported grains, frequently subsidized by foreign governments. To seal their fate, the Salinas administration introduced constitutional changes...to facilitate the sale of desirable plots to agro-industrial interests.

(Barkin 1997: 24-25)

The wage data on Mexico is truly disturbing. During the post-war "golden age" and just beyond, to 1975, the average real wage in manufacturing rose by 133%, while the real minimum wage rose by roughly 300%. Since then, the average manufacturing wage has fallen by some 16%, while the real minimum wage has collapsed, falling by roughly 70%, to a level that is now below that of 1939 and only just above its lowest point ever, in 1951 (*NACLA: Report on the Americas* 1997: 23).

The other Latin American case which highlights the growing disparity between apparent macroeconomic and financial success and acute human and social distress, is that of Argentina. In 1997 it was reported that

in macroeconomic terms, the country has never had it so good since the thirties, when Argentina ranked as one of the fifteen wealthiest countries. GDP has grown by 8 percent in the past 12 months. Inflation, once crippling, is virtually non-existent, and foreign investment is pouring in.

(Legrand 1997: 17)

At the same time, social unrest had become endemic, as various groups try to resist their effective expropriation. Teachers on hunger strike in front of the Congress buildings, were attracting significant public support as they protested "against their paltry salaries and the lack of funds going into education. The biggest teachers' union claims that teachers now get only 37% of their 1980

pay.” (Legrand 1997: 17)

And the teachers were only an extreme example of a much wider and more general trend as described in 1998:

The neoliberal shock of the 1990s has had dramatic negative effects on employment and income distribution. Between 1975 and 1995, real wages fell by 42%, and the unemployment rate increased 6.7 times. While most jobs lost in the 1990s were stable jobs in the formal sector, most of the newly created jobs are precarious, underpaid positions in low-productivity sectors ... Since the mid-1970s, the richest 10% of the population raised its share of income by 30.7%, at the expense of the middle class, the traditional working class and the very poor. In 1993 the United Nations Development Program estimated that Argentina ranked fifteenth out of 155 countries in income received by the richest 20% of the population. Since then, the share of the richest has grown from 51% to over 57%, while the share of the poorest fell by 18.7%. Between 1974 and 1995, the percentage of Argentines below the poverty line grew from 4% to 25.8% of all families.

(Azpiazu, Basualdo, and Nochteff 1998: 16-19)

Admittedly this is an extreme case, but it reflects a general trend and lends further support to the proposition that this is an endemic feature of the neoliberal policy regime. And it is important to remember that the data on inequality and on real wages does not tell the whole story. The widespread deterioration in working conditions is another equally important feature of this global process of restructuring. Here too the Argentine case is striking, since “structural job instability has become the central issue for the Argentine labour movement,” with the

proliferation of ‘garbage contracts,’ which last from three to six months and have no provision for severance payments in the event of layoffs. The labour force is continually rotated, making union organization difficult. Wages and working conditions have also been deeply affected by these pro-business reforms.

(Cieza 1998: 24)

In fact in Argentina as elsewhere, this policy regime has not only undermined the social base of the labour movement, but has in fact pushed through a structural reorganization of work itself. Stable, long-term employment has been increasingly replaced with term- employment contracts and informal work that offers workers little stability and no social security benefits.

Of course, this restructuring of the labour market has a very important political objective, apart from the obvious economic desire to reduce shortterm labour costs. As a matter of fact, the neoliberal policy regime constitutes nothing less than “a systematic effort to undermine the power and the gains of the labour movement” (Cieza 1998: 20) and this fact needs to be addressed by those, like Mr. Somavia, who suggest that we should accept the neoliberal model because it is “necessary,” but ask that, in future, a higher priority be attached to “the provision of decent work and social protection.” But whom are we to ask? And is this not primarily a political question? After all, those who are making the gains seem unlikely to relinquish them just for the asking. In fact, their most likely would probably echo the President of Argentina’s response to a protest march by 30,000 people in 1997: “They can go on a 1,000 marches and organise 1,000 strikes, but it won’t change anything.” (Legrand 1997: 17) In other words, change will come only as a result of the exercise of political power. And the ability of various interests to exercise such power is being reconstructed by the neoliberal revolution, even as it extols the virtues of democracy. More specifically, the ability of capital to exercise such power is being expanded systematically, deliberately and aggressively through the present process of globalisation. Those who deplore and fear the consequences of that process need to address the root cause, difficult as that may be.

In the Latin American context, as in Africa, the evidence has made it increasingly difficult to avoid the conclusion that the policies themselves need to be reassessed. But, as before, the “official” response is to reject this apparently obvious conclusion, in favour of yet another injunction asking (other) people to “stay the course” – however long and difficult the transition may turn out to be. Thus, at an Ibero-American summit in Venezuela in 1997, there was widespread agreement as to “the facts.” The World Bank’s representative declared that:

We are very concerned about the increase in income inequality and the lack of progress in income distribution in this region over the last decade  
(Koch-Weser in Colitt 1997: 7).<sup>21</sup>

And these conclusions echoed those reached by UNCTAD, which reported in 1997 that

While there was a pronounced tendency for inequality to increase in Latin America during the debt crisis of the 1980s, the subsequent recovery has not been sufficient to reverse this tendency.  
(*Trade and Development Report* 1997: 109)

However, most of those at this summit were anxious to insist that these observations should, on no account, lead to a loss of confidence in the orthodox policy regime.

Yet, despite the rise in income inequality, multilateral lending institutions warn of back-tracking. After reshaping the state and empowering local government through decentralisation in the past decade...the region must now implement 'a much more difficult, second generation of reforms.'

(Colitt 1997: 7)

But the problem with such a total ideological commitment to a particular policy regime, regardless of the evidence, is that it may ultimately be overwhelmed by the "real world." And there were a few observers at this meeting who made this point, that "unless more people participate in the gains of economic reforms, these may come to a grinding halt amid lack of popular credibility". And "It's a time bomb," said Frederico Mayor, director general of Unesco, of the social disparities and asymmetries in the distribution of wealth." (Colitt 1997: 7)

It is, of course, unknown how long the fuse on this time-bomb may be. But we can be certain that even when it explodes, the true ideologues will learn nothing because their beliefs are immune to the evidence. Hence they would simply blame the failure of their policies on the social unrest, or on some aspect of the process of social disintegration, like corruption, government failure to enforce contracts or public sector inefficiency. What they do not appear to understand is that wise policies must take such issues into account. These are not exogenous factors, to be blamed when things go wrong. They are an essential part of the policy process and any policy regime that does not deal with them is ultimately indefensible.

The most sobering thought is that these extremely disappointing outcomes have emerged in an extended period of apparent prosperity; a period when foreign capital was flooding into the continent on a very large scale. And one has to wonder what to expect when the next major financial crisis erupts, which is undoubtedly only a matter of time. The results will be grim, since that next crisis will impinge on societies that are often already stretched to breaking point after so many years of unsuccessful adjustment; societies whose governments will be less able to respond constructively to such developments because fifteen years of neoliberal restructuring have left them with less moral authority, fewer resources, weaker administrative capabilities (largely due to downsizing, persistent budget cuts and rock bottom civil service morale) and fewer sovereign powers - as many potentially useful policy instruments have now been proscribed by new international treaties and institutions that threaten anyone

who would try to use them, with massive economic retaliation.

But worst of all, these governments will often be less willing to mitigate the impact of such a crisis, because increasing economic inequality has tended to undermine the substance of democracy by turning elections into media events that are driven – and increasingly determined – by money; because domestic political processes have been more deeply penetrated by international firms and institutions; because the willingness of the central (imperial?) powers to threaten, to punish or to intervene in the affairs of sovereign states, has escalated in recent years; and because the general ideological climate has become more tolerant of obscenely wealthy elites imposing almost unlimited hardship while claiming to “know” that this is the only way to really help the poor, in the long run.

### **ASIA: THE ERSTWHILE EXCEPTION THAT PROVES THE RULE**

Asia has, of course, been the great exception to this relentless litany of woe, and it is a significant exception since it is home to more than one half of the world’s population, and since many of its people have made dramatic gains over the past quarter century. But, even so, it is not immune to the global pressures and financial speculation has also become a major problem in that region in recent years. Moreover, Asia’s positive experience up to this point in time, does not invalidate the view that the neoliberal policy regime represents a systematic threat to people and their societies, if it is allowed to run its course unchallenged. Indeed, properly understood, the Asian experience actually supports the thesis that a politically managed “social market” represents the only potentially sustainable, defensible and desirable form of capitalism; and that the deregulated neoliberal market is a predatory, unstable and destructive force that is ultimately socially and politically damaging – and economically inefficient. Indeed, as Asia is forced, or persuaded, to further liberalise its financial markets, it may also have occasion to learn this bitter lesson at first hand one day in the not too distant future.

### **The Causes of the Crisis**

This part of the debate has focused on the question of how blame for the crisis can be allocated as between “internal factors” and “the international financial system.” In effect this is a spurious and misleading distinction, since the adequacy or inadequacy of internal conditions cannot be assessed, or defined, except in relation to the external.

Imagine a box on top of which I stack an increasingly heavy weight. Eventually the box will collapse and we can then have an endless philosophical debate about whether the box collapsed because of the external weight, as common

sense would suggest, or whether it collapsed because of its basic structural weakness. Of course, both are necessarily true. The most important point that needs to be understood at the outset is that the financial systems of most of the Asian economies had been extremely stable and effective for a long period prior to the crisis. Moreover, they had presided over processes of social and economic transformation that were almost unprecedented in history. On that basis alone, it is highly implausible to suggest that these systems were inherently flawed and fundamentally “at fault.”

As a matter of fact, if one compares the performance of the financial systems of South Korea and Taiwan on the one hand, to those of the United States and Canada on the other, over the quarter century from 1973 to 1997, the former appear in a very favourable light.

### **The East Asian Financial Systems (Korea/Taiwan): 1973-1997**

Over these years they financed the transformation of technologically and economically underdeveloped low income economies into intensely competitive industrial economies with significant national technological capabilities that allowed them to generate and to appropriate technology rents and to remain competitive even while real wages and per capita incomes rose in a sustained and dramatic way.

Moreover, this growth was primarily financed from domestic resources that were mobilised by financial systems that acted as very effective financial intermediaries sustaining high levels of national savings on the basis of low interest rates, while channelling those resources into the real economy in a very effective and strategic manner, working closely with their respective developmental states.

These systems proved remarkably resilient and capable of absorbing severe disturbances, including the two oil crises, the Third World debt crisis and the dramatic increase in the volatility of international exchange rates. They could do this because the risks associated with an industrial sector heavily dependent on bank loans could be managed so long as interest rates were domestically determined and they could create credit when necessary.

Most importantly, the relative “cost” of these financial sectors remained low. Profitability in these sectors remained modest even as other income, including wages and rural incomes, rose rapidly. Meanwhile these systems largely avoided the creation of large speculative bubbles or, as in the case of the Taiwanese stock market bubble, managed to limit their impact on the real economy.

### **The North American Financial Systems (United States/Canada): 1973-1997**

These financial sectors were far more profitable and they expanded dramatically relative to the rest of the economy. But they presided over real economies that grew much more slowly than they had over the previous quarter century; in which real wage incomes, and real family incomes, stagnated or declined for most of the population; in which income inequality grew explosively; and in which non-financial business grew very little, while the financial sector grew extremely rapidly.

At the same time they presided over economies in which national savings rates declined further from already low levels; in which investment in the real economy was often depressed (especially in Canada); and in which a series of major speculative bubbles repeatedly distorted prices and incomes, at great cost to economy and society.

Finally, and almost incredibly, these financial systems made very little contribution to industrial investment, almost all of which was derived from retained corporate earnings.

Given these comparative performances, it would be a mystery why it is the East Asian systems that now “have to be” restructured in the image of the North American ones, if such changes were mainly driven by arguments and research findings. But they are not.

To understand the crisis and the responses to it we need also to consider the changes that were occurring in the international system. Thus we need to understand that once the WTO had successfully concluded the Global Telecommunications Agreement it immediately set its sights on negotiating a Global Financial Services Agreement. The deadline was set for December 1997, but by April 1997 the London Financial Times reported that the talks were stalled largely because of a distinct lack of enthusiasm in Asia. This was described as a matter of grave concern to the WTO officials and to the financial services industry, which was actively and publicly promoting these negotiations. In response this industry established a small but influential group of senior executives who were sent out to lobby Asia’s leaders and to gain their support.

In July of 1997, the Thai baht came under attack – and the rest is history. Mahathir’s charge at the December Fund meetings in Hong Kong, that the attack on the Asian currencies was politically motivated, was ridiculed by George Soros and others. But there can be no doubt that politics played an important role in these events. The financial markets clearly wanted more unrestricted access to Asian markets, which were growing rapidly while economic conditions



in much of the rest of the world were increasingly precarious. The industry was working with the WTO to this end, while the United States had made no secret of its desire to see these markets liberalised. It is not a “conspiracy theory” to suggest that these political circumstances were relevant to the emergence of the crisis – and to its eventual outcome. Indeed, those political factors must be integrated into any fair or independent assessment of these events.

Given the turmoil that followed the Asian crisis, and the sudden need for urgent “rescue packages,” the Asian government opposition to a Financial Services Agreement eroded rapidly and an Agreement was duly signed just a few minutes after the original midnight deadline. The real meaning of these events was clarified a few months later when Larry Summers, the US government’s Deputy Secretary of the Treasury, announced that in just a few months, the Asian crisis had achieved more policy change in Korea than two decades of tough bilateral bargaining between the US and Korea. And a few months later the London Financial Times wrote in an editorial dealing with the threatened collapse of the Long-term Capital Management hedge fund (LTCM), that it was now clear that the largest hedge funds had “engaged in concerted action” as the Asian crisis was breaking.

Of course no one strand of this argument can stand on its own. While the international financial services industry, and the US government, had a clear and declared interest in bringing about certain changes in Asia’s financial markets, that alone does not explain the crisis. For that we need to understand the process through which the opportunity to exploit a crisis to this end, presented itself. And that opportunity ultimately presented itself because of the severe imbalances that emerged in their domestic economies as these countries opened their previously stable and highly successful financial sectors to the outside world. In this sense, domestic imbalances and contradictions rightly assume great significance as the immediate triggers of the crisis. But it is important to remember that those “domestic” problems reflected both external and internal developments.

The truth is that speculative bubbles had been growing in a number of Asian economies since the early nineties. In fact, when Japan’s bubble economy had collapsed in the early nineties, the Far Eastern Economic Review reported a large exodus of “financial gunslingers.” These were quoted as saying that the Japanese market would be dead for some time to come, because of the mountains of bad debt that the bubble had left in its wake, they were off to other Asian centres where they expected to participate in similar speculative activities. Hence they were decamping to other Asian centres where they proposed to repeat that same process. And they did.

By 1997 it was obvious that many Asian markets were ripe for a major “adjustment.” Indeed, for two years before the 1997 crisis, I used to say at every opportunity that it was foolish to extrapolate the Asian miracle into the future without recognising that “water runs downhill in Asia, just like anywhere else in the world;” and “speculative bubbles must collapse in Asia, just as anywhere else in the world.” Indeed, in a paper that I wrote in May 1997, I had written that:

Watching the wild developments on the world’s bond and stock markets in 1997 one would have to agree with the cynics. Stock market valuations are simply outlandish and historically without precedent by now; bond markets have lost touch with reality, as large issues from bankrupt countries are regularly heavily over-subscribed; and property markets in many parts of the world, but especially in Asia, have reached dizzying heights from which they have a long way to fall. In May of 1997, the conservative Asia Times suggested that a ‘global financial meltdown’ now had to be considered a real possibility, and anyone without a vested interest in the process would have to agree.

The important point to understand is that this was a global problem, manifesting itself in many different parts of the global economy. At its heart lay a rising tide of global liquidity that has become the dominant feature of the world economy and that began when national authorities effectively lost control over the issuance of money in the seventies. The problem could now manifest itself so virulently in Asia because many of the Asian economies had been persuaded, cajoled or pressured into opening their financial sectors to the outside world. This had not been so before, and that was a major reason why most of Asia, apart from the Philippines, had found itself in a relatively favourable position in the early eighties when the debt crisis had engulfed Latin America and Africa, ushering in their “lost development decades.”

Moreover, it is important to note that this more closed Asia did not stagnate or decline as a result. It did not even suffer from a lack of access to capital. In fact, this Asia was the engine of the world economy, attracting foreign capital to complement its high domestic savings, and using those resources to build relatively stable, dynamic, strategically directed economies in which the benefits of growth were widely shared; and which rapidly growing domestic markets could sustain favourable investment climates.

By 1997 these models had been compromised by financial liberalisation. The resulting large imbalances in their financial sectors began to have an increasing

impact on their real economies – first through the balance of payments, then through the price distortions caused by property speculation and finally through the impact of escalating debt burdens on institutions and firms, which became explosive once exchange rates began to fall.

In short, any discussion of the causes of the Asian crisis should put a lot of emphasis on “domestic factors,” especially if it is looking to identify the immediate triggers of the crisis. But the domestic factors that emerge from such an analysis are neither inherently Asian, nor purely domestic. They are reflections of the incompatibility between the open, volatile international capital markets and “the Asian models.” And the fact that it is those models that are now being deconstructed is nothing short of a tragedy.

It is a tragedy because those “Asian models,” despite their various shortcomings, were the only models that have actually allowed a few societies to achieve “genuine development” over the past fifty years. And the fact that they are now being aggressively dismantled augurs ill for the future of the developing world, including that of Asia. That is the most serious consequence of the Asian crisis; and that is what one has to bear in mind in thinking about appropriate responses to that crisis.

### **The Policy Responses to the Crisis**

The policy responses to the crisis have been entirely predictable for anyone who believes that such responses will be largely determined by interests rather than arguments. The main result has been a dramatic opening up of many Asian economies, including their financial sectors. As Larry Summers has said so bluntly, these events have radically advanced the long standing policy agenda of the United States, as well as those of the financial industry and the International Financial Institutions. And this was possible because the crisis sharply undermined the bargaining positions of most Asian governments.

On the other hand, those policy responses are much harder to understand for those who believe that these should primarily reflect the best available knowledge and the latest research findings. While the early stages of the crisis witnessed a certain expansion in the range of issues considered in public policy debates, the real impact of the crisis has been to deepen the entrenchment of the neoliberal orthodoxy that was already dominant prior to the crisis. Thus there is nothing that is new in the responses to this crisis. They contain the same injunctions: to unleash market forces, to increase transparency and to tighten prudential regulation. And nothing has been done to deal with the contradictions between these injunctions, or to deal with the fact that they don’t actually turn out to mean anything, when they are carefully examined.

Initially it seemed that more radical responses might be forthcoming as several big names in the financial world announced that these events were proof that current, excessively deregulated international financial markets were dangerously unstable and had to be curbed to protect the greater good. Some were prepared to follow the architects of the original Bretton Woods agreement and to call for the re-introduction of capital controls, effectively agreeing with Keynes that the absence of such controls would condemn the international economy to chronic instability.

Others were not prepared to go that far in interfering with markets, and some of these called for curbs on the power of the IMF/World Bank to impose far reaching conditions in return for emergency finance; or for some version of the Tobin tax in order to discourage short-term capital flows; or for the establishment of much larger buffer funds to allow the inevitable recurring crises to be better managed.

Alongside the debates about better financial market regulation, there were other debates about the appropriateness of the macroeconomic stabilisation measures being applied to the distressed Asian economies. These revolved centrally around the question of whether the IMF's normal, deflationary stabilisation policies were appropriate for Asian countries that were already suffering serious downturns due to the collapse of a wide range of private sector projects and contracts. While these concerns were undoubtedly well founded, there was also much to be said for the claim that one could not simply reflate these economies. What was actually required, however, went far beyond the narrow confines of these debates. In effect a solution to these problems requires the links between national financial systems, and national real economies to be re-established. Or, in other words, it requires a revival of the earlier successful Asian models even though this will be declared impossible by those who wish to integrate these economies fully into the orbit of international finance.

At this point, roughly three years after the onset of the crisis, nothing appears to have been learned in the leading financial institutions; no new solutions have been devised; and any resumption of capital flows is immediately greeted by claims that the crisis is over and happy days are here again. Meanwhile the Asian models are being dismantled and effectively Latin Americanised. As such they may enjoy reasonable growth for significant periods; and a few, that have appropriate domestic institutions, might be able to combine that growth with a modest diffusion of benefits to their populations. But these successes will be severely limited because they will all become far more unstable, far more unequal and far less able to develop or to sustain domestic technological

capabilities. And only such capabilities could allow them to generate and to appropriate the technology rents that could provide a basis for a sustained increase in real wages and a broadly rising standard of living for their populations.

At this point one might recall an article in the London Financial Times which appeared soon after Korea was admitted to the OECD. The article bluntly told the Koreans that, now that they were part of the OECD, they would have to restructure their economy and, in particular, they would have to do away with those excessively high wages and repeal the “inefficient” labour legislation that made it so difficult for firms to fire employees, and to treat labour as a “casual factor of production” (human capital?) that could be used more effectively to absorb the uncertainties transmitted from those increasingly unstable international markets. Incidentally, this same article confirmed the fact that, by this time, Korean wages often exceeded those paid in industrial countries, so that a recent decision to establish a Korean auto assembly plant in Britain was described as a move to a cheap labour location.

The further deregulation of financial markets; the widespread privatisation and sale of national assets to foreign interests; the restructuring of labour markets will all contribute to the Latin Americanisation of Asia. The result will be income polarisation; greater instability; and an increasing loss of national control over technologies and over the policy process as foreign interests come to play a dominant role in the domestic political process. And far from preventing future financial crises, this will make them endemic.

So what of the policy proposals that have emerged in the wake of the crisis? Let us first examine those emanating from the IMF. The central thrust of these has been to reinforce the message that stability can only be attained if we allow markets to function even more freely. Hence the Fund has not reversed the initial steps taken in December 1997 which cleared the way for amending its Articles of Agreement so as to make the removal of capital controls an obligation of membership, which would be a complete reversal of the original Articles which provided for the permanent right of national governments to impose capital controls. The central thrust of the Fund’s policy stance thus continues to promote the creation of one liberal global financial market and this objective is constantly reiterated by Mr. Camdessus and others, even though elsewhere, the Fund has conceded that a case can sometimes be made for temporary and limited capital controls.

The demand for greater transparency is pretty implausible as a solution to the recurrence of financial crises, but it does imply a powerful extension of the

Fund's intrusive powers of surveillance. In fact the transparency debate misrepresents the issue by implying that this is a case where "more is always better." The implication is always: What do "they" have to hide? But elsewhere this same issue is discussed as a problem of "disclosure," though here it is usually firms or financial institutions that have to "be transparent" vis-a-vis governments. This debate is far more sensitive to the fact that the rights of the supervisor have to be balanced against those of the supervised. Ironically, some of the same people who are militantly demanding complete transparency from governments vis-a-vis the IMF, will be found defending the right of financial institutions to protect commercially sensitive, or other kinds of information. Of course, governments should be granted such rights on a far greater scale since the world is not a free market world – and in an imperfect world, strategic behaviour is rational and necessary. And strategic behaviour requires a degree of non-transparency. Moreover, interests differ and the IMF is not a neutral, objective actor but is firmly on the side of the global financial markets in these debates. Hence the demand that governments should be completely transparent to the IMF is an unconscionable, far-reaching demand that has deeply problematic political implications. Ironically such demands are often said to be seeking to "depoliticise" the operation of the financial system. This is of course patent nonsense.

Apart from all of this, the claim that transparency would avoid – or substantially reduce – the incidence of speculation misunderstands that process, which is rooted in psychology and in herd behaviour. It is not helpful to think of this process as one in which investors are trying to establish the "appropriate" price of Russian bonds, based on that country's economic circumstances and prospects. They are not. The speculators operating in Bangkok knew that prices had become divorced from "real values" long before July 1997, but they kept buying property so long as they believed that someone else would buy it from them at a higher price. Transparency will not curb this, and could even foster it.

As for prudential regulation, this is a heavy phrase with a very light meaning. At bottom the acceptance that there is a need for a prudential regulator, poses a serious and often unacknowledged problem for those who extol the virtues of liberal financial markets. Their preference is based on the assumption that market actors are best able to make use of available information, best able to judge various opportunities, and best able to make judgements about risk and uncertainty – because in the usual mythology – they are risking "their own" assets. But when such people also accept the need for "prudential regulation" this raises a very difficult problem. After all, if "someone" is to second guess the judgements made by the market, then that "someone" must have superior knowledge and the capacity to act in accordance with that knowledge – i.e. in

the public interest. But if such a “someone” does exist, then where does that leave the case for market determined investment flows? Why could that someone not manage a public investment fund?

The hard truth is that prudential regulators are virtually abdicating their responsibilities in many areas of the market in the face of the increasing complexity of financial instruments; in the face of the limited resources at their disposal; and in the face of their limited power. Thus the derivatives markets remain largely unregulated; and the toughest proposals now on the table speak only of “the possibility” of considering somewhat greater disclosure requirements of the hedge funds. In fact these institutions are currently effectively unregulated. (You may recall that at the height of the LTCM crisis, the chairman peremptorily rejected demands asking him to disclose “any of his funds activities.”) And even the much discussed capital adequacy ratios established by the BIS in the eighties have come under attack and have been displaced by new regulations now allowing the larger banks to use their own, in house risk management models to ensure adequate prudence.

Finally there is the problem of defining what is meant by the phrase “adequate prudential regulation.” If one asks: Who is now being adequately regulated? It turns out to be very difficult to provide an answer because, as the World Bank has recently shown, no less than 69 countries have suffered major banking crises since 1970, and this includes many (most?) of the developed OECD countries that have apparently sophisticated regulatory mechanisms. And in most of these cases the net worth of the entire banking systems actually turned negative, and rescue costs were often astronomical, sometimes reaching 10% or 15% of GDP. But if we do not have any clear examples of effective regulatory regimes, then what meaning can we attach to the phrase “adequate prudential regulation?”

As for larger buffer funds, and early warning systems, these also fail to grasp the nature of the problem. Larger buffer funds increase moral hazard, as is widely recognised. In fact, it is well to remember Kindleberger’s two absolutely unbreakable rules that must be observed without fail by those running a credit based economy. Rule 1: Those who over-extend themselves in the financial markets must not be bailed out. And Rule 2: When many institutions and individuals have over-extended themselves at one time, they must be bailed out. In short, larger buffer funds will encourage speculation. And the demand for early warning systems raises the same problem as that for prudential regulation. Who is to give the warning? And who will take it seriously? And what of the reasons why, at present, bad news is often not divulged for fear of triggering a crisis?

The Tobin tax is an important idea and one that deserves support but it will do little to solve the larger problem. It is important because it implies recognition that there is a problem and it therefore lays the foundations for further action, when this measure turns out to be ineffective. The measure is unlikely to have a major impact because it is most unlikely that such arbitraging activities would be highly sensitive to such a marginal increase in costs. Moreover, the worst case scenario might be one in which such a tax succeeded in raising a lot of revenue, which might then be made available to an institution like the IMF, thereby further extending the influence of the international financial markets that one is seeking to control.

This leaves capital controls, the solution that Keynes and White had insisted on building into the early Bretton Woods system, based on their understanding of the disastrous events of the 20s and 30s. Their optimism that such controls could enhance stability without strangling growth, was amply justified by the Golden Age (1948-1973) during which the global economy performed extremely well despite the most inauspicious initial circumstances. And their fear that the absence of such controls would condemn the world to instability, slow growth, conflict and unemployment have also been borne out by developments since the demise of the early Bretton Woods system in the early seventies.

Those who oppose capital controls do so on a number of grounds. They argue that capital flows are vital to growth and prosperity, especially in the developing world. And they argue that such controls are unenforceable either for technical reasons (electronics and all that); or because good flows cannot be distinguished from bad ones; or because people will simply refuse to accept such controls. Hence they argue that we must simply learn to live with instability.

Those who disagree accept that these difficulties exist, but they do not see them as insurmountable. And they also tend to believe that the costs of having to live with that instability may be far too high.

I will say little about the first claim that capital flows are essential for growth and development. I do not think a strong case can be made for this claim either in theory or in terms of the historical record, and I was very pleased to see that Jagdish Bhagwati has made an impassioned statement to this effect.

The other three arguments are also ultimately unpersuasive, although they raise important issues. The technology argument is actually the weakest of the three, even though it is the most widely and most glibly used. The truth is that electronic transactions can actually be very effectively traced, which means that



technologically speaking, enforcement has almost certainly become easier in this new environment.

The problem of distinguishing good from bad flows is insurmountable in an absolute or definitive sense, but fortunately the matter does not have to be resolved definitively. The precise definitions can be left to individual countries, and their interpretation would eventually come before the courts, as in most other areas of the law.

This leaves the final obstacle, people's willingness to obey such a law, and this could turn out to be the biggest obstacle of all. Undoubtedly if governments are to rebuild the capacity to manage their domestic economies in accordance with democratically legitimated social and political objectives, then they will have to strengthen, or to recreate, a sense of citizenship that is strong enough to provide the ideological foundations for such laws. The truth is that laws are enforceable at reasonable cost only if most people accept them as just and fair, but the creation of such a sense of citizenship is an increasingly difficult task as communications become more global.

In any case, we continue to have examples of countries making effective use of capital controls, although the Asian crisis has reduced their number significantly. Thus, as is well known, Malaysia has reintroduced such controls in the context of the Asian crisis and China appears to have abandoned its plans to dismantle its controls in the wake of the crisis. Indeed, at a recent meeting in Bangkok, a senior Chinese official reported that China felt that it had been saved from making this "grave mistake" by the Asian crisis.

The reason why capital controls are of such importance is the same as the reason why national money and currency is so important. Indeed, the one is dependent on the other. The reason is rooted in the fact that citizenship denotes an acceptance of mutual interests and obligations; of rights and responsibilities; of one's membership in a collective enterprise based on democratic choices about social and economic priorities. As a citizen one contributes to these and benefits from these in a variety of ways. But this contract only makes sense if citizens are bound, or obligated, by their citizenship, to enjoy the benefits, or to suffer the consequences, of the choices that they have made. And that is possible only in a national economic space whose fortunes will be determined by those choices and will be reflected in the value of a national money and currency.

To clarify this point, it is instructive to examine it from the opposite point of view. In a book written more than a decade ago, Richard Harris, one of Canada's leading neoclassical economists, discussed the possible implications of Canada's

entry into a free trade agreement with the US. Having acknowledged that such an arrangement would entail “social risks” because it would expose the economy more directly to external events, he noted that some people used this to argue that those risks had to be managed and that they should be explicitly considered in deciding whether or not to enter into such an agreement. But Harris describes this argument as “simplistic,” on the grounds that it does not take account of the fact that people could “hedge against such risks in the world’s capital markets,” but that “this is not true” for owners of “less mobile factors of production” like resources or labour! The point is clear. Working people are citizens of a country in a very different sense from owners of capital. And that difference is a major potential problem, politically, socially and economically. And this asymmetry has everything to do with the presence or absence of capital controls.

### **The Future of the Crisis and Concluding Remarks**

If the current dismantling of the Asian model is carried to completion, Asia will be Latin Americanised. The result will be a steady dilution of the meaning of citizenship; a steady increase in social inequality; an increase in social instability and in various social pathologies; a decrease in the capacity of governments to collect taxes, or to manage their economies; a decline in national savings rates and an increase in real interest rates and in the cost of capital, as uncertainty and risk increases.

Productive capacities will come increasingly under foreign control so that technology rents will flow out of these countries, and this will put downward pressure on wages.

In essence, the Asian countries will lose the great advantage that some of them had under the previous model, namely their ability to make coherent, strategically informed decisions; to mobilise savings effectively; and to engage their populations in national development processes that were both dynamic and fair enough to sustain people’s support and to harness their energies. Some people erroneously ascribed these outcomes to “Confucian culture” but I believe that, if current trends continue, Asia will soon discover that these advantages will soon disappear as their societies polarise and become increasingly unstable and unpredictable.

In the former Soviet Union the situation is, if anything, even more dramatic. Here the scale of the economic collapse has been almost unimaginable and hardly needs elaboration since it has been so widely documented. Thus:

Economic surveys read like disaster reports. Gross national product, which fell by about half between 1990 and 1995, dropped by 6 percent

last year. Industrial production, which had slid by even more during the 1990-95 period, fell by another 9 percent. The collapse of investment and light industry is even more dramatic. True, these figures must be taken with a grain of salt, since a parallel economy is gaining ground.... Fiscal fraud has reached epidemic proportions. Companies don't pay taxes, either because they cannot afford to or because they speculate, 'lending' money to the state by buying bonds. With its coffers empty, the state is slashing social services and delays payments. The elderly and disabled have to wait for pensions, public servants for their salaries. Industrial workers whether in the private or public sector, fare no better.

(Singer 1997: 20)

The impact on the social and political fabric of the nation is maybe even more ominous. A recent report speaks of:

a deepening and corrosive threat to Russia's young democracy and free-market economy: the breakdown of law enforcement and the proliferation of private armies and protection rackets prone to ruthless gangland tactics.

(Hoffman 1997: AO1)

But, as elsewhere, the true ideologues are not swayed by the evidence. Even in the face of these extreme outcomes, they merely demanded even more radical reforms, or more time, or they blame "unfavourable circumstances" for having undermined their "rational policies." For turning even more power over to the market, even though that market is often not competitive; and even though the "social capital" (Stiglitz 1998) that is needed if markets are to function effectively, or in the public interest, either does not exist, or is actively being destroyed.

There are, of course, other alternatives. One in which some countries follow China in recognising the importance of reversing those current trends and rebuilding a more vibrant model, anchored in a regional structure that provides liquidity on the basis of a different set of conditions. Conditions that require recipient countries to rebuild the ideological, institutional and infrastructural foundations that supported the earlier successful Asian models.

At the very centre of such a project lies the task of rebuilding monetary stability and reconstructing the links between national financial systems and national real economies. And that requires a degree of disengagement from an international financial system that is now awash in liquidity; that is endemically unstable; and in which the power to create credit has become effectively unlimited and uncontrolled. Until that problem is addressed and solved, the world will be

condemned to suffer repeated and escalating bouts of instability that will continue to impose huge welfare losses on the weakest, stifle investment and growth and fuel inequality and conflict.

At some point Polanyi's double movement will see societies react by reasserting control over their circumstances. We can only hope that this day will come sooner rather than later. And we must recognise that Asia may well take the lead in that process.

Of course we must also hope that those who are profiting so handsomely from the current anarchy will not be prepared to deploy their smart bombs and their star wars technologies to defend their current poisonous privileges. But that has to be regarded as a very real possibility.

Nor can this process be excused on the grounds that it is necessary for ensuring high levels of future investment and growth. In fact, this argument was always controversial and has recently been further weakened by an accumulation of empirical research suggesting that income inequality is frequently detrimental to growth and prosperity. One 1994 study of 56 countries found "a strong negative relationship between income inequality and growth in GDP per head," (Persson and Tabellini 1994: 21) and this merely echoed the conclusions reached by several other authoritative studies. As a result:

Many economists are now revising their views, having begun to see greater income equality as compatible with faster growth - and perhaps even contributing to it.... 'It's a major shift in economists' perspectives' Joseph Stiglitz, a member of the President's Council of Economic Advisers, said. 'There are lessons here for the United States.... Not only did trickle-down economics not solve the problems of the poor or the middle class, but it was bad growth policy.' Some researchers...argued that in Asian countries, there was a direct cause-and-effect link between faster growth and policies that reduce inequality. 'One of the strongest lessons from Asia is that equality is not only a corollary, but may actually stimulate economic growth' said Professor Sabot of Williams College, the co-author of a study with Ms. Birdsall, 'Inequality and Growth Reconsidered.'

(Nasar 1994: 17)

Elsewhere, doubts about the desirability and the sustainability of the neoliberal revolution have arisen even among some prominent former advocates, in face of the accumulating evidence. Thus, John Gray, a former advisor to Mrs. Thatcher, now regards these policies as misguided and unsustainable because they tend to

destroy the social values, networks and institutions on which the efficient operation of markets ultimately depends. Moreover, like Keynes, he sees the free flow of international capital as the main mechanism that is undermining the government's ability to protect these networks.

History exemplifies an equally important fact: Free-market economies lack built-in stabilizers. Without effective management by government, they are liable to recurrent booms and busts – with all their costs in social cohesion and political stability.... The current era of free capital flows cannot survive much longer. Internationally coordinated movement toward a new regime of regulation is the only alternative to the disastrous prospect of tit-for-tat protectionism.<sup>22</sup>

(Gray 1998: 17-18)

A similar conclusion was reached by Paul Krugman in a recent article in which he warns against the comfortable assumption that we need no longer fear a serious, cumulative deflationary spiral, like the one that led to the thirties depression. While reflationary policies will normally avert such a possibility, the complexity and the scale of international finance entanglements have once again reached the point where totally unpredictable and incomprehensible disturbances have become a real and dangerous fact of life. As a result:

it is hard to avoid concluding that sooner or later we will have to turn the clock at least part of the way back: to limit capital flows for countries that are unsuitable for either currency unions or free floating; to reregulate financial markets to some extent; and to seek low but not too low inflation rather than price stability. We must heed the lessons of Depression economics, lest we be forced to relearn them the hard way.

(Krugman 1999: 74)

However, despite such straws in the wind, the neoliberal advance continues as new international treaties and institutions try to lock governments ever more firmly into that policy regime. The Asian crisis has actually been used as a lever for opening up the financial systems of these economies and within the main international financial institutions the demand for the further liberalisation of markets remains in the ascendant. Meanwhile, welfare reform in the US is continuing to remove the vestigial safety net that had been protecting labour from becoming a “pure commodity,” and similar reforms are reducing worker protection in much of the world.

## Notes

<sup>1</sup> In an article published in *The New Statesman* in July/August 1933 Keynes had written that

the greatest challenge facing the capitalist system was to learn to live with a rate of profit that would gradually approach zero as capital became more and more abundant (Keynes 1933).

<sup>2</sup> This phrase was repeatedly used by a Wall Street analyst (Weinstock) who appeared with Sylvia Ostry and me on a September 1993 panel to discuss the “economic issues underlying the up-coming Canadian election” with the journalists of the Canadian Broadcasting Corporation.

<sup>3</sup> “The Middle Kingdom,” *The Toronto Globe and Mail*, 24 March 1997 (p A7) reporting on a study by the Canadian Council on Social Development authored by Grant Schellenberg and David Ross.

<sup>4</sup> In a remarkable series of papers, Joseph Stiglitz, writing as the World Bank’s Chief Economist, has argued that these policies have often been misguided and destructive and has variously referred to the “Washington Consensus” as a “misguided,” “dogmatic,” and “fundamentalist” approach to policy making (See Stiglitz 1997, 1998, 1999).

<sup>5</sup> The per capita prison population in the US is extremely high – and rising.

<sup>6</sup> The most extreme being the infamous “three strikes you’re out” laws that require the courts in many states to impose long-term prison sentences even for minor offences, if the offender has two previous convictions.

<sup>7</sup> See my article in Southall et al.

<sup>8</sup> This is the term used by Deepak Lal to describe the new fundamentalist belief that the laws of economics apply universally across space and time, thereby rejecting the more pragmatic approach of “development economics,” which had sought to modify its policy prescriptions for the developing world in ways that took account of its institutional, cultural and geopolitical specificities (Lall 1983).

<sup>9</sup> Amazingly, in its 1988 report entitled *Structural Adjustment: Ten Years of Experience*, the World Bank actually referred disparagingly to its earlier policy advice as “text book policy,” and welcomed the fact that it was learning to “go beyond” such naive and misguided advice, by taking more adequate account of the particular circumstances of low income countries like those in SSA.

<sup>10</sup> This phrase was used by Ronald Reagan in a speech commending the IMF for its militant promotion of market oriented policies around the world.

<sup>11</sup> After fifteen years of intransigence – and only when the disastrous consequences of the demand for “full repayment” had become over-whelmingly evident.

<sup>12</sup> World Bank 1988: 24.

<sup>13</sup> This has to do both with the scale and the timing of outcomes. Neoliberal “adjustment” requires countries to take on new debts, new obligations, and new risks. The hope is that these will enhance efficiency, investment, and growth on a sufficient scale to service those debts, fulfil those obligations and, manage those risks. And, as every businessman knows, if they

fail to do so in time, they will fail; they will further deepen the economic, social, and political crisis.

<sup>14</sup> R. Agarwala and P.N. Schwartz (w. Jean Ponchamni) “Sub- Saharan Africa: A Long-term Perspective Study,” Paper written for the Learning Process on Participatory Development, World Bank: Washington D.C., May 1994 (mimeo): 3, 4.

<sup>15</sup> This is precisely the way – i.e. the accumulation of anomalies - in which Thomas Kuhn described the demise of any scientific paradigm, creating the need for an alternative paradigm to take its place (Kuhn 1970).

<sup>16</sup> “...The alternative paradigm of the social market became acceptable in light of the experience in several donor countries [i.e. the Nordic countries, Germany and Holland].”

<sup>17</sup> The Bank’s efforts to ensure “consistency” between its policy prescriptions and its “research results” have often led to unseemly conflicts as researchers have sought to protect their findings from dilution, or worse. See Robert Wade’s article describing the horse-trading that preceded the Bank’s “Miracle Report,” and especially the Bank’s efforts to suppress a report issued by its own Operations Evaluation Division because it disagreed with the Bank’s standard policy prescriptions. A senior member of staff was quoted as saying that the Bank did not want to publish this report, because “people might think that it was changing its policies, if it were to do so. So much for the idea, that the policy should be based on the research results. It seems in this Alice in Wonderland world, the research results have to be brought into line with the policy.” (Wade 1996)

<sup>18</sup> Given the latent tensions created by the period of repression and torture, the arrival of democracy occurred in a context where governments had to be seen to be addressing the welfare issue. And because Chile’s administrative capacity was relatively well developed, and because its communities and its civil society organisations were relatively strong, it was able to achieve a lot, with a little. However, these conditions will be eroded over time, as neoliberalism undermines civil service capabilities through downsizing and fiscal cuts, and as the organising capacity of communities and of civil society organisations is eroded by the cynicism and conflict that is engendered by these divisive, inequitable policies. Moreover, the government’s commitment to dealing with the welfare issue does also have to be balanced against pressures emanating from other sources, and especially from the financial markets, both national and international. And, over time, their demands for cost reduction and for fiscal restraint will tend to become dominant, especially in the periods of crisis that are an inevitable feature of the unstable world associated with deregulated global finance.

<sup>19</sup> It is important to remember that Chile’s first attempt at economic liberalisation ended in disaster in the early eighties. And that experience meant that the “second attempt” was much more cautious, especially as regards financial liberalisation.

<sup>20</sup> ILO “Despite decade-long reforms, social progress risks stalling in Latin America, Caribbean, warns new ILO report,” Press release simultaneously released in Lima (Peru) and Geneva (Switzerland), ILO/99/26, 23 August.

<sup>21</sup> Caio Koch-Weser, managing operations director at the Bank as cited in R. Colitt “Latin American reforms ‘fail to cut income disparities’,” *The (London) Financial Times*, 13

November 1997: 7.

<sup>22</sup> John Gray “Not for the First Time, World Sours on Free Markets,” *The Nation*, 19 October 1998: 17-18. This article summarises the argument developed in his book *False Dawn: The Delusions of Global Capitalism*, Granta Books: London, 1998.

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